

CHANGE REQUEST COVER SHEET

Change Request Number: 13-105

Date Received: 9/13/2013

Title: AMS Real Property Guidance Updates

Name: Charles Baldwin

Phone: 571-205-8427

Policy OR Guidance: Guidance

Section/Text Location Affected: 2.31. 2.3.2, 3.1.5, 6.2

Summary of Change: Minor changes have been made to real estate guidance based on requests from the field.

Reason for Change: These changes have been made to clarify inspection and acceptance, alterations and improvement, capitalization, and the real estate certification program.

Development, Review, and/or Concurrence: ALO-200, AGC-520, WLSA, ELSA, CLSA, ALO-300

Target Audience: Real Estate Contracting Officers

Potential Links within FAST for the Change: N/A

Briefing Planned: No

ASAG Responsibilities: None

Potential Links within FAST for the Change: N/A

Links for New/Modified Forms (or) Documents (LINK 1) [null](#)

Links for New/Modified Forms (or) Documents (LINK 2) [null](#)

Links for New/Modified Forms (or) Documents (LINK 3) [null](#)

SECTIONS EDITED:

Real Estate Guidance :

Section 2.3.1 : Inspection and Acceptance [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

Real Estate Guidance :

Section 2.3.2 : Alterations and Improvements [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

Real Estate Guidance :

Section 3.1.5 : Capitalization [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

Real Estate Guidance :

Section 6.2.1 : Attaining Real Estate Contracting Officer/Realty Specialist

(RECO/Realty Specialist) Certification [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

Real Estate Guidance :

Section 6.2.2 : Maintaining Real Estate Contracting Officer/Realty Specialist

(RECO/Realty Specialist) Certification [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

SECTIONS EDITED:

Section 2.3.1 : Inspection and Acceptance

Old Content: Real Estate Guidance :

Section 2.3.1 : Inspection and Acceptance

The RECO should arrange to inspect the space sufficiently in advance of the required occupancy date to ensure that it is ready for the customer. The lessor must provide evidence of a valid occupancy permit at this time unless the local jurisdiction does not issue occupancy permits.

Acceptance may be provided in writing or verbally with any discrepancies or unfinished items noted in the lease file. In most cases the FAA and the lessor will agree to discrepancies in writing. However when large deficiencies remain it is often advantageous to delay acceptance until they are completed. The lease should be amended to reflect the actual commencement date.

Minor deficiencies are often referred to as "punch list items". These items need not prevent acceptance of space and commencement of rent. A follow-up inspection should be scheduled to ensure that the deficiencies are corrected. The results of the follow-up inspection should be documented in the file.

New Content: Real Estate Guidance :

Section 2.3.1 : Inspection and Acceptance

The RECO should arrange to inspect the space sufficiently in advance of the required occupancy date to ensure that it is ready for the customer. The lessor must provide evidence of a valid occupancy permit at this time unless the local jurisdiction does not issue occupancy permits, in which case the RECO can accept a certified copy of the FAA Safety and Environmental Checklist in lieu of an occupancy permit.

Acceptance may be provided in writing or verbally with any discrepancies or unfinished items noted in the lease file. In most cases the FAA and the lessor will agree to discrepancies in writing. However when large deficiencies remain it is often advantageous to delay acceptance until they are completed. The lease should be amended to reflect the actual commencement date.

Minor deficiencies are often referred to as "punch list items". These items need not prevent acceptance of space and commencement of rent. A follow-up inspection should be scheduled to ensure that the deficiencies are corrected. The results of the follow-up inspection should be documented in the file.

Red Line Content: Real Estate Guidance :
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The RECO should arrange to inspect the space sufficiently in advance of the required occupancy date to ensure that it is ready for the customer.- The lessor must provide evidence of a valid occupancy permit at this time unless the local jurisdiction does not issue occupancy permits, *in which case the RECO can accept a certified copy of the FAA Safety and Environmental Checklist in lieu of an occupancy permit.*

Acceptance may be provided in writing or verbally with any discrepancies or unfinished items noted in the lease file. In most cases the FAA and the lessor will agree to discrepancies in writing. However when large deficiencies remain it is often advantageous to delay acceptance until they are completed. The lease should be amended to reflect the actual commencement date.

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Section 2.3.2 : Alterations and Improvements

Old Content: Real Estate Guidance :
Section 2.3.2 : Alterations and Improvements

Alterations or improvements done by the lessor may be amortized over the term of the lease, made by lump-sum payment, or other method determined appropriate by the RECO. Alterations and Improvement under an existing lease generally are considered single source and do not require competition.

1.) *Alterations*

It is normally in the FAA's best interest to have the lessor perform alterations in his/her own building, thereby eliminating any question of liability on the part of the FAA.

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Alterations performed under an existing FAA lease by the lessor should be at a fair and reasonable cost. Determination of fair and reasonable may be made by 1.) formal appraisal, 2.) construction data, 3.) cost to build publications, and 4.) independent government cost estimate.

2.) *Improvements*

The FAA can make permanent improvements to private facilities under the provisions of the lease agreement. The ability to make permanent improvements using a third party is governed by 1.) 49 USC Section 44502 (a)(5) and the decision by the Comptroller General B-239520 (8/16/90).

The lessor should be considered first in providing improvements. Improvements should be evaluated for their value using FAA accounting practices. Determination of fair and reasonable may be made by 1.) formal appraisal, 2.) construction data, 3.) cost to build publications, and independent government estimate.

If the lessor is unwilling or unable to provide the means to complete the improvements, then the FAA can exercise the authority under 49 USC Section 44502(a)(5).

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If the lessor is unwilling or unable to provide the means to complete the improvements, then the FAA can exercise the authority under 49 USC Section 44502(a)(5).

For all alterations and improvements dealing with large construction of leased space, the RECO may use the engineers/architects from Design and Construction, ALO-100C, to verify the cost estimates.

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Section 3.1.5 : Capitalization

Old Content: Real Estate Guidance :

Section 3.1.5 : Capitalization

Capitalization is not to be confused with accountability. In general, capitalization is the method of treating an asset as it relates to an agreed upon set of accounting principals. Accountability is keeping track or being aware of assets or items determined important because of their use, value, or significance. Capitalization and accountability of assets will overlap but should not be considered synonymous.

The threshold policy for capitalization of assets, other than land, is \$25,000 and a useful life of at least two years. Land purchases will be capitalized at any cost. Land only leases that do not provide a bargain purchase option and do not result in FAA ownership during the term of the lease, are not capitalized.

The FAA is required to capitalize certain improvements in both owned and leased space (See The Accounting Capitalization Desk Guide). Also, the FAA is required to make a determination as to whether leases (including real property leases) are capital or operating leases and insure they are reflected correctly in the financial system. Documentation relating to capital improvements and determinations of capital versus operating leases is to be retained in the appropriate lease file. Documentation, as a minimum, should consist of the form "Evaluation of Real Property Lease to determine Accounting Treatment". Specific information and guidance relating to capitalization and capital leases is contained in Accounting Capitalization Desk Guide and the PRISM/DELPHI Business Process: Capital Lease any conflicts in capitalization guidance will use Accounting Capitalization Desk Guide as the final authority. The Project/Material Management Desk Guide also contains information pertinent to the capitalization of real property asset.

Typically, the determination of whether a lease will be a capital lease is accomplished well in advance of site acquisition because of the possible budget score-keeping (OMB Circular A-11, Appendix B) that may be required. Consultation with the requesting Line of Business (LOB) regarding OMB Circular A-11 requirements should be done prior to any commitment on the part of the FAA.

There are six criteria to determine whether a lease is capital or operating. Because such phrases as “long duration” and “high payment” are subjective, OMB Circular A-11 sets forth which six criteria listed below to be used by Federal agencies in distinguishing between an operating lease, a capital lease, or a lease-purchase. If either of the first two criteria is not met, the lease is classified as a *lease-purchase*. If the first two criteria are met and one or more of the other four criteria listed below are not met, the lease is classified as a *capital lease*. If and only if all six criteria are met is a lease classified as an *operating lease*.

1. *Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease term.*
2. *The lease does not contain a bargain-price purchase option.*
3. *The lease term does not exceed 75 percent of the estimated economic life of the asset.*
4. *The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the beginning of the lease term.*
5. *The asset is a general-purpose asset rather than for a special purpose of the Federal government and is not built to unique specification of the Government as lessee.*
6. *There is a private sector market for the asset.*

Although the foregoing criteria are simply stated, additional clarification is needed in order to apply them.

Bargain-price purchase options

The test for bargain-price purchase options contains no time restrictions as to when the option might be exercised, whether prior to or years after the expiration of the lease. This can be particularly critical in situations where the improvements themselves are leased for, say, 20 years, but then revert to the Government at little or no cost upon expiration of an associated ground lease after 50 years.

Leases that contain such options are classified as lease-purchases.

90 percent test

For purposes of the 90 percent test, the *minimum lease payment* is the annual net rent (full service rent less all fixed and operating expenses) and specifically does not include real estate taxes. The discount rate to be used in doing the present value computations is specified in the annual update to OMB Circular A-94 Appendix C, as typically published each February. Discount rates are specified for terms of 3, 5, 7, 10, and 30 years, and are used over the next 12 months independent of interest rate fluctuations. Discount rates for lease terms other than 3, 5, 7,

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10, and 30 years are established through straight-forward interpolation. The real discount rates appearing in OMB Circular A-94 Appendix C are to be used in conducting the 90 percent test and the subsequent impact on budget authority, as well as for calculating net present values needed to identify the lowest cost space alternative available to the Government. For cost-benefit analyses involving alternative (third-party) financing, however, the equivalent cost of capital for Government funding is to be based on the yield rates for Treasury obligations of similar durations that are published weekly by the Federal Reserve Board in Bulletin H-15 (available online). The lease term used in performing the 90 percent test is to include the firm term of the lease plus all options and extensions

Special Purpose

Any project constructed or located on Government owned land is presumed to be for a special purpose of the Government, and is therefore ineligible for classification as an operating lease. However, as part of the 2003 amendment to OMB Circular A-11, if the Government ground leases property to a non-Federal party and then subsequently leases back the improvements, the leaseback may be treated as an operating lease if it otherwise meets the criteria for an operating lease.

PRISM/DELPHI

In the PRISM/DELPHI procurement and financial system, tests 5 and 6 are generally considered to be met and that normally is the case with FAA leases. However the CO should be aware of the criteria in the event of a rare circumstance, where those criteria may apply. Any questions regarding tests 5 or 6 should be referred to Real Property Policy for a determination. The CO completes the “Evaluation of Lease to Determine Accounting Treatment” form and submits to their accounting office with their lease package. NOTE: There is a form for both real property and personal property leases). The form is designed to screen out certain leases that can automatically be considered operating leases or capital leases, and provide necessary information for performing the remaining tests. Also in the

DELPHI system, the determination must be completed in DELPHI Fixed Assets Module by the servicing accounting office, unless it is automatically classified as an operating lease. See the PRISM/DELPHI Business Process Solution: Capital Leases for further information on processing of lease evaluations, operating and capital leases.

Fair Market Value

Fair Market Value – The highest priced in terms of money which a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and sell, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.

- **Determining Fair Market Value (FMV) for Lease Evaluation Purposes**

The lease evaluation must be as of the date of lease inception and use the FMV as of lease inception date. For new leases, FMV is best determined during the market survey. The CO will also need to determine the FMV of certain modifications that change the term and/or scope of the lease, since they must be evaluated separately from the original lease.

Per OBM Circular A-11, the market approach is most preferable, followed by replacement cost. Circular A-11 does not discuss income approach but this is also an acceptable approach per real property appraisal practice. Property tax assessment can be used to help establish FMV if it is tied directly to a reasonable fair market value – with the caveat that some adjustments may be needed, depending on the taxing districts policies. Discussions with real estate brokers in the area can reveal correlations between tax-assessed value and fair market value.

When determining FMV of the real property under lease, remember that this is a reasonable estimate of FMV to be used for internal accounting purposes only – so do not contemplate using this estimate for formal appraisal/legal purposes. There is no one single method to arrive at this estimate, and

COs should remember the three approaches to estimating FMV – Market, Replacement Cost and Income approaches. The CO should make an effort to make an estimate using at least two of these approaches and then make a judgment (**do not average**) as to *the appropriate* FMV when comparing the values arrived at by different approaches. It should be noted that the full value of the building or asset being leased is used for lease evaluations, even when the FAA is only leasing a portion of the building/asset.

- **Accepted Method for Retroactive Determinations of FMV:**

The accepted process for estimating FMV in those cases where there is not sufficient documentation available to establish original FMV on retroactive evaluations of existing leases, is to establish FMV for the property under lease as of the new evaluation date (now), and then discounting the FMV using the Consumer Price Index (CPI). Use the same CPI Index used for Lease Services and Utilities CPI Adjustment. Link to CPI Site: <http://www.bls.gov/cpi/>. Utilize CPI schedule for Wage Earners and Clerical Workers, Not Seasonally Adjusted, US City Average. Base Period 1982-84= 100. Multiply current FMV x Inception CPI value /Current CPI value to arrive at an adjusted FMV for lease inception. This shall be the standardized method of estimating the FMV for prior years in absence of actual documentation of FMV at lease inception.

- **Estimated Useful Life For Capitalization:**

In determining whether a lease is operating or a capital lease you will need to know the estimated useful life of a particular asset. The FAA has made a determination for the following types of assets:

- 40 yrs. Offices and Warehouse buildings (including commercial, governmental, air traffic control towers and enroute air traffic control centers) and residential properties.
 - 20 yrs. Mobile Homes
 - 15 yrs. Other Structures (i.e., Roads, Sidewalks, Parking Lots, etc.)
 - 10 yrs. Capital improvements, Facility Modifications, Leasehold Improvements (or expiration of lease, whichever comes first).
- **Amortization**

When a lease is considered capital because FAA will during or at the end of the lease term take title to the property or the lease contains a bargain purchase option, the asset is amortized over the estimated useful life of the asset, not the lease term.

When a lease is considered capital because the 75 percent of the estimated useful life or 90 percent of fair value criteria is met, the asset is amortized over the term of the lease.

Leasehold improvements are amortized over:

- The remaining term of the lease OR
- The useful life of the asset (the improvement), which ever is less.

All capital leases and capitalized improvements will need to be reported to your local accounting organization.

- **Liquidated Damages**

If lease contract requires some form of liquidated damages clause (where the FAA agrees to pay some form of damages for ending the lease early) the Real Estate Contracting Officer must coordinate with the LOB to ensure they understand that funds for any potential liquidated damages must also be scored in the LOBs budget, to ensure there would be no shortfall of funds, should the FAA terminate early. Information on Liquidated Damages is contained in: [OMB Circular A-11, Appendix B](#).

- OMB Review Certain Requirements

Effective with publishing of this document, the RECO must be aware that OMB now requires review of certain Leases, as outline in [OMB Circular A-11, Appendix B](#) long before they are awarded. The types of projects are shown below as follows:

- Any proposed lease where total Government payments over the term of the lease (including any options) will exceed 50 Million dollars.
- All Non-Routine financial proposals, such as:
 - Outlease-Leaseback arrangements
 - Establishment of public-private partnerships

- Issuance of debt by a 3rd party that includes an explicit “full faith and credit” guarantee of the United States of America .
- Special purpose assets for which there is no real market.
- Enhanced –use leases with leasebacks, with manual payments that exceeds the following annual rent threshold:
 - 2006 - \$2,410,000
 - 2007 - \$2,600,000
- Projects constructed on Public land
- Service Contracts that require the contractor to acquire or construct assets greater than \$50 Million.
- Share in Savings proposals that result in the acquisition of real property.
- Any financing proposal for which requires OMB approval of the scoring or compliance with OMB Circular A-11.
- Arrangements that grant special tax status
- Leases that involve options that can be conveyed to a third party in exchange for future consideration.

New Content: Real Estate Guidance :

Section 3.1.5 : Capitalization

Capitalization is not to be confused with accountability. In general, capitalization is the method of treating an asset as it relates to an agreed upon set of accounting principles. Accountability is keeping track or being aware of assets or items determined important because of their use, value, or significance. Capitalization and accountability of assets will overlap but should not be considered synonymous.

The FAA Financial Manual establishes the threshold value for capitalizing assets. Assets that fit the Financial Manual definition of "capital assets" must undergo a process to ensure that they are properly "capitalized" in agency financial and property records. As of October 1, 2008, FAA Financial Manual Volume 5, Chapter 3 "Property, Plant and Equipment", section 030202 "Capitalization Criteria", requires capitalization of assets meeting certain criteria. Land is always characterized as a capital asset. Generally, a non-land asset must be capitalized if it has an estimated useful life of at least two years and has a total unit cost of \$100,000 or more (e.g., roads, perimeter fences, etc.) The FAA is required to capitalize certain improvements in both owned and leased space (See The Accounting Capitalization Desk Guide). Also, the FAA is required to make a determination as to whether leases (including real property leases) are capital or operating leases and insure they are reflected correctly in the financial system. Documentation relating to capital improvements and determinations of capital versus operating leases is to be retained in the appropriate lease file. Documentation, as a minimum, should consist of the form "Evaluation of Real Property Lease to determine Accounting Treatment". Specific information and guidance relating to capitalization and capital leases is contained in Accounting Capitalization Desk Guide and the PRISM/DELPHI Business Process: Capital Lease any conflicts in capitalization guidance will use Accounting Capitalization Desk Guide as the final

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Typically, the determination of whether a lease will be a capital lease is accomplished well in advance of site acquisition because of the possible budget score-keeping (OMB Circular A-11, Appendix B) that may be required. Consultation with the requesting Line of Business (LOB) regarding OMB Circular A-11 requirements should be done prior to any commitment on the part of the FAA. *Land-only leases that do not provide a bargain purchase option and do not result in FAA ownership during the term of the lease are not capitalized. FAA owned land is always characterized as a capital asset.*

There are six criteria to determine whether a lease is capital or operating. Because such phrases as “long duration” and “high payment” are subjective, OMB Circular A-11 sets forth which six criteria listed below to be used by Federal agencies in distinguishing between an operating lease, a capital lease, or a lease-purchase. If either of the first two criteria is not met, the lease is classified as a *lease-purchase*. If the first two criteria are met and one or more of the other four criteria listed below are not met, the lease is classified as a *capital lease*. If and only if all six criteria are met is a lease classified as an *operating lease*.

- 1. Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease term.*
- 2. The lease does not contain a bargain-price purchase option.*
- 3. The lease term does not exceed 75 percent of the estimated economic life of the asset.*
- 4. The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the beginning of the lease term.*
- 5. The asset is a general-purpose asset rather than for a special purpose of the Federal government and is not built to unique specification of the Government as lessee.*
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The test for bargain-price purchase options contains no time restrictions as to when the option might be exercised, whether prior to or years after the expiration of the lease. This can be particularly critical in situations where the improvements themselves are leased for, say, 20 years, but then revert to the Government at little or no cost upon expiration of an associated ground lease after 50 years.

Leases that contain such options are classified as lease-purchases.

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- **Accepted Method for Retroactive Determinations of FMV:**

The accepted process for estimating FMV in those cases where there is not sufficient documentation available to establish original FMV on retroactive evaluations of existing leases, is to establish FMV for the property under lease as of the new evaluation date (now), and then discounting the FMV using the [Consumer Price Index \(CPI\)](#). Use the same CPI Index used for Lease Services and Utilities CPI Adjustment. Utilize CPI schedule for Wage Earners and Clerical Workers, Not Seasonally Adjusted, US City Average. Base Period 1982-84= 100. Multiply current FMV x Inception CPI value /Current CPI value to arrive at an adjusted FMV for lease inception. This shall be the standardized method of estimating the FMV for prior years in absence of actual documentation of FMV at lease inception.

- **Estimated Useful Life For Capitalization:**

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 - 20 yrs. Mobile Homes
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- **Amortization**

When a lease is considered capital because FAA will during or at the end of the lease term take title to the property or the lease contains a bargain purchase option, the asset is amortized over the estimated useful life of the asset, not the lease term.

When a lease is considered capital because the 75 percent of the estimated useful life or 90 percent of fair value criteria is met, the asset is amortized over the term of the lease.

Leasehold improvements are amortized over:

- The remaining term of the lease OR
- The useful life of the asset (the improvement), which ever is less.

All capital leases and capitalized improvements will need to be reported to your local accounting organization.

- **Liquidated Damages**

If lease contract requires some form of liquidated damages clause (where the FAA agrees to pay some form of damages for ending the lease early) the Real Estate Contracting Officer must coordinate with the LOB to ensure they understand that funds for any potential liquidated damages must also be scored in the LOBs budget, to ensure there would be no shortfall of funds, should the FAA terminate early. Information on Liquidated Damages is contained in: [OMB Circular A-11, Appendix B](#).

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 - Outlease-Leaseback arrangements
 - Establishment of public-private partnerships
 - Issuance of debt by a 3rd party that includes an explicit “full faith and credit” guarantee of the United States of America.
 - Special purpose assets for which there is no real market.
 - Enhanced –use leases with leasebacks, with manual payments that exceeds the following annual rent threshold:
 - 2006 - \$2,410,000
 - 2007 - \$2,600,000
 - Projects constructed on Public land
 - Service Contracts that require the contractor to acquire or construct assets greater than \$50 Million.
 - Share in Savings proposals that result in the acquisition of real property.
 - Any financing proposal for which requires OMB approval of the scoring or compliance with OMB Circular A-11.
 - Arrangements that grant special tax status
 - Leases that involve options that can be conveyed to a third party in exchange for future consideration.

Red Line Content: Real Estate Guidance :

Section 3.1.5 : Capitalization

Capitalization is not to be confused with accountability. In general, capitalization is the method of treating an asset as it relates to an agreed upon set of accounting ~~principals~~principles. Accountability is keeping track or being aware of assets or items determined important because of their use, value, or significance. Capitalization and accountability of assets will overlap but should not be considered synonymous.

The FAA Financial Manual establishes the threshold ~~policy~~value for ~~capitalization~~capitalizing ~~assets~~. Assets that fit the Financial Manual definition of "capital assets" must undergo a process to ensure that they are properly "capitalized" in agency financial and property records. As of October 1, other 2008, than FAA land Financial Manual Volume 5, is Chapter \$253 "Property, 000 Plant and a Equipment", useful section life 030202 "Capitalization Criteria", requires capitalization of at least two years assets meeting certain criteria. Land purchases will be capitalized at any cost is always characterized as a capital asset. Land Generally, only a leases non-land that do not provide a bargain purchase option and do not result in FAA ownership during the asset must be capitalized if it has an estimated useful life of at least two years and term has a total unit cost of the \$100,000 lease or more (e.g., are roads, not perimeter capitalized fences, etc.-) The FAA is required to capitalize certain improvements in both owned and leased space (See The Accounting Capitalization Desk Guide). Also, the FAA is required to make a determination as to whether leases (including real

property leases) are capital or operating leases and insure they are reflected correctly in the financial system. Documentation relating to capital improvements and determinations of capital versus operating leases is to be retained in the appropriate lease file. Documentation, as a minimum, should consist of the form "Evaluation of Real Property Lease to determine Accounting Treatment". Specific information and guidance relating to capitalization and capital leases is contained in Accounting Capitalization Desk Guide and the PRISM/DELPHI Business Process: Capital Lease any conflicts in capitalization guidance will use Accounting Capitalization Desk Guide as the final authority. The Project/Material Management Desk Guide also contains information pertinent to the capitalization of real property asset.

Typically, the determination of whether a lease will be a capital lease is accomplished well in advance of site acquisition because of the possible budget score-keeping (OMB Circular A-11, Appendix B) that may be required. Consultation with the requesting Line of Business (LOB) regarding OMB Circular A-11 requirements should be done prior to any commitment on the part of the FAA. **Land-only leases that do not provide a bargain purchase option and do not result in FAA ownership during the term of the lease are not capitalized. FAA owned land is always characterized as a capital asset.**

There are six criteria to determine whether a lease is capital or operating. **Because such phrases as "long duration" and "high payment" are subjective, OMB Circular A-11 sets forth which six criteria listed below to be used by Federal agencies in distinguishing between an operating lease, a capital lease, or a lease-purchase. If either of the first two criteria is not met, the lease is classified as a lease-purchase. If the first two criteria are met and one or more of the other four criteria listed below are not met, the lease is classified as a capital lease. If and only if all six criteria are met is a lease classified as an operating lease.**

There are six criteria to determine whether a lease is capital or operating. Because such phrases as "long duration" and "high payment" are subjective, OMB Circular A-11 sets forth which six criteria listed below to be used by Federal agencies in distinguishing between an operating lease, a capital lease, or a lease-purchase. If either of the first two criteria is not met, the lease is classified as a *lease-purchase*. If the first two criteria are met and one or more of the other four criteria listed below are not met, the lease is classified as a *capital lease*. If and only if all six criteria are met is a lease classified as an *operating lease*.

- 1. Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease term.*
- 2. The lease does not contain a bargain-price purchase option.*
- 3. The lease term does not exceed 75 percent of the estimated economic life of the asset.*
- 4. The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the beginning of the lease term.*

5. *The asset is a general-purpose asset rather than for a special purpose of the Federal government and is not built to unique specification of the Government as lessee.*

6. *There is a private sector market for the asset.*

~~Although the foregoing criteria are simply stated, additional clarification is needed in order to apply them.~~ **Bargain-price purchase options**

The test for bargain-price purchase options contains no time restrictions as to when the option might be exercised, whether prior to or years after the expiration of the lease. This can be particularly critical in situations where the improvements themselves are leased for, say, 20 years, but then revert to the Government at little or no cost upon expiration of an associated ground lease after 50 years.

Leases that contain such options are classified as lease-purchases.

90 percent test

For purposes of the 90 percent test, the *minimum lease payment* is the annual net rent (full service rent less all fixed and operating expenses) and specifically does not include real estate taxes. The discount rate to be used in doing the present value computations is specified in the annual update to OMB Circular A-94 Appendix C, as typically published each February. Discount rates are specified for terms of 3, 5, 7, 10, and 30 years, and are used over the next 12 months independent of interest rate fluctuations. Discount rates for lease terms other than 3, 5, 7, 10, and 30 years are established through straight-forward interpolation. The real discount rates appearing in OMB Circular A-94 Appendix C are to be used in conducting the 90 percent test and the subsequent impact on budget authority, as well as for calculating net present values needed to identify the lowest cost space alternative available to the Government. For cost-benefit analyses involving alternative (third-party) financing, however, the equivalent cost of capital for Government funding is to be based on the yield rates for Treasury obligations of similar durations that are published weekly by the Federal Reserve Board in Bulletin H-15 (available online). The lease term used in performing the 90 percent test is to include the firm term of the lease plus all options and extensions

Special Purpose

Any project constructed or located on Government owned land is presumed to be for a special purpose of the Government, and is therefore ineligible for classification as an operating lease. However, as part of the 2003 amendment to OMB Circular A-11, if the Government ground leases property to a non-Federal party and then subsequently leases back the improvements, the leaseback may be treated as an operating lease if it otherwise meets the criteria for an operating lease.

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In the PRISM/DELPHI procurement and financial system, tests 5 and 6 are generally considered to be met and that normally is the case with FAA leases. However the CO should be aware of the criteria in the event of a rare circumstance, where those criteria may apply. Any questions regarding tests 5 or 6 should be referred to Real Property Policy for a determination. The CO completes the “Evaluation of Lease to Determine Accounting Treatment” form and submits to their accounting office with their lease package. NOTE: There is a form for both real property and personal property leases). The form is designed to screen out certain leases that can automatically be considered operating leases or capital leases, and provide necessary information for performing the remaining tests. Also in the ~~DELPHI-system~~ system, the determination must be completed in DELPHI Fixed Assets Module by the servicing accounting office, unless it is automatically classified as an operating lease. See the PRISM/DELPHI Business Process Solution: Capital Leases for further information on processing of lease evaluations, operating and capital leases.

Fair Market Value

Fair Market Value – The highest priced in terms of money which a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and sell, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.

- **Determining Fair Market Value (FMV) for Lease Evaluation Purposes**

The lease evaluation must be as of the date of lease inception and use the FMV as of lease inception date. For new leases, FMV is best determined during the market survey. The CO will also need to determine the FMV of certain modifications that change the term and/or scope of the lease, since they must be evaluated separately from the original lease.

Per OBM Circular A-11, the market approach is most preferable, followed by replacement cost. Circular A-11 does not discuss income approach but this is also an acceptable approach per real property appraisal practice. Property tax assessment can be used to help establish FMV if it is tied directly to a reasonable fair market value – with the caveat that some adjustments may be needed, depending on the taxing districts policies. Discussions with real estate brokers in the area can reveal correlations between tax-assessed value and fair market value.

When determining FMV of the real property under lease, remember that this is a reasonable estimate of FMV to be used for internal accounting purposes only – so do not contemplate using this estimate for formal appraisal/legal purposes. There is no one single method to arrive at this estimate, and COs ~~should~~ should remember the three approaches to estimating FMV – Market, Replacement Cost and Income approaches. The CO should make an effort to make an estimate using at least two of these approaches and then make a judgment (**do not average**) as to *the appropriate* FMV when comparing the values arrived at by different approaches. It should be noted that the full value of the building or asset being leased is used for lease evaluations, even when the FAA is only leasing a portion of the building/asset.

- **Accepted Method for Retroactive Determinations of FMV:**

The accepted process for estimating FMV in those cases where there is not sufficient documentation available to establish original FMV on retroactive evaluations of existing leases, is to establish FMV for the property under lease as of the new evaluation date (now), and then discounting the FMV using the Consumer Price Index (CPI). Use the same CPI Index used for Lease Services and Utilities CPI Adjustment. Link to CPI Site: <http://www.bls.gov/cpi/>. Utilize CPI schedule for Wage Earners and Clerical Workers, Not Seasonally Adjusted, US City Average. Base Period 1982-84= 100. Multiply current FMV x Inception CPI value /Current CPI value to arrive at an adjusted FMV for lease inception. This shall be the standardized method of estimating the FMV for prior years in absence of actual documentation of FMV at lease inception.

- **Estimated Useful Life For Capitalization:**

In determining whether a lease is operating or a capital lease you will need to know the estimated useful life of a particular asset. The FAA has made a determination for the following types of assets:

- 40 yrs. Offices and Warehouse buildings (including commercial, governmental, air traffic control towers and enroute air traffic control centers) and residential properties.
- 20 yrs. Mobile Homes
- 15 yrs. Other Structures (i.e., Roads, Sidewalks, Parking Lots, etc.)
- 10 yrs. Capital improvements, Facility Modifications, Leasehold Improvements (or expiration of lease, whichever comes first).

- **Amortization**

When a lease is considered capital because FAA will during or at the end of the lease term take title to the property or the lease contains a bargain purchase option, the asset is amortized over the estimated useful life of the asset, not the lease term.

When a lease is considered capital because the 75 percent of the estimated useful life or 90 percent of fair value criteria is met, the asset is amortized over the term of the lease.

Leasehold improvements are amortized over:

- The remaining term of the lease OR
- The useful life of the asset (the improvement), which ever is less.

All capital leases and capitalized improvements will need to be reported to your local accounting organization.

- **Liquidated Damages**

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If lease contract requires some form of liquidated damages clause (where the FAA agrees to pay some form of damages for ending the lease early) the Real Estate Contracting Officer must coordinate with the LOB to ensure they understand that funds for any potential liquidated damages must also be scored in the LOBs budget, to ensure there would be no shortfall of funds, should the FAA terminate early. Information on Liquidated Damages is contained in: [OMB Circular A-11, Appendix B](#).

- OMB Review Certain Requirements

Effective with publishing of this document, the RECO must be aware that OMB now requires review of certain Leases, as outline in [OMB Circular A-11, Appendix B](#) long before they are awarded. The types of projects are shown below as follows:

- Any proposed lease where total Government payments over the term of the lease (including any options) will exceed 50 Million dollars.
- All Non-Routine financial proposals, such as:
 - Outlease-Leaseback arrangements
 - Establishment of public-private partnerships
 - Issuance of debt by a 3rd party that includes an explicit “full faith and credit” guarantee of the United States of America-
 - Special purpose assets for which there is no real market.
 - Enhanced –use leases with leasebacks, with manual payments that exceeds the following annual rent threshold:
 - 2006 - \$2,410,000
 - 2007 - \$2,600,000
 - Projects constructed on Public land
 - Service Contracts that require the contractor to acquire or construct assets greater than \$50 Million.
 - Share in Savings proposals that result in the acquisition of real property.
 - Any financing proposal for which requires OMB approval of the scoring or compliance with OMB Circular A-11.
 - Arrangements that grant special tax status
 - Leases that involve options that can be conveyed to a third party in exchange for future consideration.

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Section 6.2.1 : Attaining Real Estate Contracting Officer/Specialist (RECO/S) Certification

Old Content: Real Estate Guidance :

Section 6.2.1 : Attaining Real Estate Contracting Officer/Specialist (RECO/S) Certification

FAA RECO/S Level I Certification - The Level I RECO/S competencies and certification program is designed to ensure the development of basic and fundamental qualifications and

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expertise by the acquisition professional. Development at the Level I is the foundation for career progression and is designed to prepare qualified personnel to progress to positions of increasing responsibility.

At Level I, RECO/S should be exposed to the basic and fundamental real estate procedures and documents. The employee performs a progressive range of responsibilities. For further information see [RECO Acquisitions Professions](#) (FAA only) for performance indicators at each level, including a variety of basic and/or routine real estate assignments under the close direction of a more experienced professional and/or manager or team lead. There is no warrant issued for achieving Level I certification.

FAA RECO/S Level II Certification - At Level II, the focus is on the ability of the RECO/S to apply specific skills and knowledge obtained previously to consummate real estate transactions. A Level II RECO/S performs multiple, varying, and progressively complex real estate functions with limited direction. Some projects may require competence in working across functional and/or organizational lines. The Level II RECO/S acts as an individual contributor and/or member of a team and may perform leadership functions for small projects/programs or other work activities. The RECO/S also develops experience and demonstrates progressively advanced competence in planning and completing assignments. Level II certified RECO/S have a limited warrant based upon the manager's assessment of competencies, experience and completed training.

FAA RECO/S Level III Certification - A Level III RECO/S should have an in-depth knowledge of the entire real estate acquisition process. The Level III RECO/S is considered a subject-matter expert in the discipline of real estate who provides leadership for highly complex and challenging activities with minimal direction. The Level III RECO/S may act as a principal specialist to develop new and innovative approaches, methodologies, and techniques, and as a leader to define and direct challenging projects/programs/activities. The Level III RECO/S identifies and resolves challenging problems or issues which often cross organizational boundaries and impact the accomplishment of strategic objectives. Level III certified RECO/S may be issued up to an unlimited warrant based upon the manager's assessment of competencies, experience and completed training.

New Content: Real Estate Guidance :

Section 6.2.1 : Attaining Real Estate Contracting Officer/Realty Specialist (RECO/Realty Specialist) Certification

FAA Realty Specialist Level I Certification - The Level I Realty Specialist competencies and certification program is designed to ensure the development of basic and fundamental qualifications and expertise by the acquisition professional. Development at the Level I is the foundation for career progression and is designed to prepare qualified personnel to progress to positions of increasing responsibility.

At Level I, RECO/Realty Specialist should be exposed to the basic and fundamental real estate procedures and documents. The employee performs a progressive range of responsibilities. For further information see [RECO Acquisitions Professions](#) (FAA only) for performance indicators at each level, including a variety of basic and/or routine real estate assignments under the close direction of a more experienced professional and/or manager or team lead. There is no warrant issued for achieving Level I certification. Level I Realty Specialists are prohibited from signing contracts or any other document that obligates the Government.

FAA RECO/Realty Specialist Level II Certification - At Level II, the focus is on the ability of the RECO/Realty Specialist to apply specific skills and knowledge obtained previously to consummate real estate transactions. A Level II RECO/Realty Specialist performs multiple, varying, and progressively complex real estate functions with limited direction. Some projects may require competence in working across functional and/or organizational lines. The Level II RECO/Realty Specialist acts as an individual contributor and/or member of a team and may perform leadership functions for small projects/programs or other work activities. The RECO/Realty Specialist also develops experience and demonstrates progressively advanced competence in planning and completing assignments. Level II certified RECO/Realty Specialist have a limited warrant based upon the manager's assessment of competencies, experience and completed training. Level II RECO/Realty Specialists granted warrants use the official title of "Real Estate Contracting Officer" when signing contracts.

FAA RECO/Realty Specialist Level III Certification - A Level III RECO/Realty Specialist should have an in-depth knowledge of the entire real estate acquisition process. The Level III RECO/Realty Specialist is considered a subject-matter expert in the discipline of real estate who provides leadership for highly complex and challenging activities with minimal direction. The Level III RECO/Realty Specialist may act as a principal specialist to develop new and innovative approaches, methodologies, and techniques, and as a leader to define and direct challenging projects/programs/activities. The Level III RECO/Realty Specialist identifies and resolves challenging problems or issues which often cross organizational boundaries and impact the accomplishment of strategic objectives. Level III certified RECO/Realty Specialist may be issued up to an unlimited warrant based upon the manager's assessment of competencies, experience and completed training. Level III RECO/Realty Specialists granted warrants use the official title of "Real Estate Contracting Officer" when signing contracts.

Red Line Content: Real Estate Guidance :

Section 6.2.1 : Attaining Real Estate Contracting Officer/Realty Specialist (RECO/SRealty Specialist) Certification

FAA RECO/SRealty Specialist Level I Certification - The Level I RECO/SRealty Specialist competencies and certification program is designed to ensure the development of basic and fundamental qualifications and expertise by the acquisition professional. Development at the Level I is the foundation for career progression and is designed to prepare qualified personnel to progress to positions of increasing responsibility.

At Level I, RECO/[SRealty Specialist](#) should be exposed to the basic and fundamental real estate procedures and documents. The employee performs a progressive range of responsibilities. For further information see [RECO Acquisitions Professions](#) (FAA only) for performance indicators at each level, including a variety of basic and/or routine real estate assignments under the close direction of a more experienced professional and/or manager or team lead. There is no warrant issued for achieving Level I certification. [Level I Realty Specialists are prohibited from signing contracts or any other document that obligates the Government.](#)

FAA RECO/[SRealty Specialist](#) Level II Certification - At Level II, the focus is on the ability of the RECO/[SRealty Specialist](#) to apply specific skills and knowledge obtained previously to consummate real estate transactions. A Level II RECO/[SRealty Specialist](#) performs multiple, varying, and progressively complex real estate functions with limited direction. Some projects may require competence in working across functional and/or organizational lines. The Level II RECO/[SRealty Specialist](#) acts as an individual contributor and/or member of a team and may perform leadership functions for small projects/programs or other work activities. The RECO/[SRealty Specialist](#) also develops experience and demonstrates progressively advanced competence in planning and completing assignments. Level II certified RECO/[SRealty Specialist](#) have a limited warrant based upon the manager's assessment of competencies, experience and completed training. [Level II RECO/Realty Specialists granted warrants use the official title of "Real Estate Contracting Officer" when signing contracts.](#)

FAA RECO/[SRealty Specialist](#) Level III Certification - A Level III RECO/[SRealty Specialist](#) should have an in-depth knowledge of the entire real estate acquisition process. The Level III RECO/[SRealty Specialist](#) is considered a subject-matter expert in the discipline of real estate who provides leadership for highly complex and challenging activities with minimal direction. The Level III RECO/[SRealty Specialist](#) may act as a principal specialist to develop new and innovative approaches, methodologies, and techniques, and as a leader to define and direct challenging projects/programs/activities. The Level III RECO/[SRealty Specialist](#) identifies and resolves challenging problems or issues which often cross organizational boundaries and impact the accomplishment of strategic objectives. Level III certified RECO/[SRealty Specialist](#) may be issued up to an unlimited warrant based upon the manager's assessment of competencies, experience and completed training. [Level III RECO/Realty Specialists granted warrants use the official title of "Real Estate Contracting Officer" when signing contracts.](#)

Section 6.2.2 : Maintaining Real Estate Contracting Officer/Specialist (RECO/S) Certification

Old Content: [Real Estate Guidance](#) :

Section 6.2.2 : Maintaining Real Estate Contracting Officer/Specialist (RECO/S) Certification

RECO/S (Level I/II/III) are required to maintain technical proficiency through the successful completion of a minimum of 80 hours of continuous learning points (CLP) of real property

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training and development during the two year recertification period. Each hour equates to a continuous learning point (CLP). The RECO/S may accomplish the above requirement through participation in workshops, seminars, symposiums, online and classroom training as well as developmental opportunities to accumulate accredited hours towards CLPs.

All education, training and development information relating to RECO/S personnel is to be entered into the enterprise Learning Management System (eLMS). In addition, each RECO/S must have a training and development plan approved by the real estate supervisor at all levels. The Real Estate Group Managers will forward copies of the training plans to the Policy and Performance Division, ALO-200.

Certification must be renewed every two-years. The FAA acquisition certification renewal application can be found in the AMS guidance section for acquisition career program and is required for submission to maintain certification.

New Content: Real Estate Guidance :

Section 6.2.2 : Maintaining Real Estate Contracting Officer/Realty Specialist (RECO/Realty Specialist) Certification

All RECO/Realty Specialists, regardless of whether they have a warrant or not (Level I/II/III), are required to maintain technical proficiency through the successful completion of a minimum of 80 hours of continuous learning points (CLP) of real property training and development during the two year recertification period. Each hour equates to a continuous learning point (CLP). The RECO/Realty Specialist may accomplish the above requirement through participation in workshops, seminars, symposiums, online and classroom training as well as developmental opportunities to accumulate accredited hours towards CLPs.

All education, training and development information relating to RECO/Realty Specialist personnel is to be entered into the enterprise Learning Management System (eLMS). In addition, each RECO/Realty Specialist must have a training and development plan approved by the real estate supervisor at all levels. The Real Estate Group Managers will forward copies of the training plans to the Aviation Logistics Organization, Planning, Policy and Performance Division (ALO-200).

Certification must be renewed every two-years. The FAA acquisition certification renewal application can be found in the AMS guidance section for acquisition career program and is required for submission to maintain certification.

Red Line Content: Real Estate Guidance :

Section 6.2.2 : Maintaining Real Estate Contracting Officer/Realty Specialist (RECO/SRealty Specialist) Certification

All RECO/SRealty Specialists, regardless of whether they have a warrant or not (Level I/II/III), are required to maintain technical proficiency through the successful completion of a minimum

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All education, training and development information relating to RECO/*SRealty Specialist* personnel is to be entered into the enterprise Learning Management System (eLMS). In addition, each RECO/*SRealty Specialist* must have a training and development plan approved by the real estate supervisor at all levels. The Real Estate Group Managers will forward copies of the training plans to the *Aviation Logistics Organization, Planning,* Policy and Performance Division; *(ALO-200)*.

Certification must be renewed every two-years. The FAA acquisition certification renewal application can be found in the AMS guidance section for acquisition career program and is required for submission to maintain certification.
